

Consultation on updating Ofwat's charging rules

Severn Trent Response

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Summary of response

We are pleased to have this opportunity to respond to Ofwat's proposed update to the charging rules.

In general, we think that the proposed changes are sensible and pragmatic. Fixing the publication dates for our various charging documents and statements of significant change is a welcome simplification. We strongly support cost-reflective charges and the harmonisation of company terminology for developer charges, which will make it easier for developer customers who work in multiple areas across the country. We also welcome Ofwat's drive to ensure greater consistency in the way that companies calculate worked examples which illustrate the charges that developers are likely to pay for a given site.

The one point which we do not support is the interpretation of the "five-year rule" for calculating infrastructure charges. We have already said - in our response to the *Consultation on the balance and scope of developer charges* - that we do not think five years is sufficiently long to consider reinforcement, which is a very long-term activity. Also, we do not think it is helpful to require infrastructure charges to be based on forward-looking costs alone, without any adjustment for the level of charges and costs actually incurred. We think it will create more variances and - through the single till - lead to greater volatility in charges for regular customers. This is at odds with the charging principles adopted elsewhere within the rules; it makes infrastructure charges less cost-reflective and brings about less stable charges for regular customers.

More detailed answers to the specific questions raised in the request are included below.

Kind regards

Shane Anderson
Director of Regulation and Strategy

Q1: Do you agree with our proposed rule changes? Please offer alternatives if you think they would better achieve our intentions.

Timing of publications

Fixed publication dates will definitely make matters simpler, as we currently need to calculate the relevant dates by counting back from the time that charges will come into effect or the date of another publication. This means that they vary from year to year.

We also think that companies should be permitted to publish the Statements of Significant Change (SOSC) at the same time as schemes. This is what we do at the indicative charges stage in October; last year the publication date for SOSC fell two days before wholesale charges schemes were due to be published and we think it would be more transparent and less confusing for non-household stakeholders to publish them on the same day.

Cost reflectivity

We fully support the principle that charging structures should reflect the long run costs associated with providing the relevant service. However, we believe that the current approach to infrastructure charge setting is in conflict with this rule because a five-year period will not represent the long-run cost of reinforcement. Moreover, Ofwat's interpretation of this rule and proposed clarification further reduces the relationship between costs and charges, as we discuss in our response to question 3.

Consistent terminology in developer charges

Severn Trent has played a full and active role in the development of consistent terms. We are content with a rule requiring companies to use the agreed terminology once all stakeholder views have been taken into account.

Worked examples for new connection charges

We support the use of worked examples to improve transparency for developers, and Ofwat's efforts to improve consistency in this area. Severn Trent have played an active role in the development of this area and agree that it is sensible to formalise this requirement within the charging rules. Developers have also indicated that a worked example of a larger scale development of say 5000 properties would be valuable, as would adding visuals/pictures.

Publishing infrastructure charges within the charging arrangements document

Infrastructure charges apply to developers and it is clearly more sensible for them to be published alongside other developer charges. This is in line with our existing practice.

Provision of income offset

We provide the income offset to any customer that connects to our network, whether this is to existing or new mains. It is sensible to clarify that this should be the case.

Network reinforcement and NAVs

This also looks like a sensible clarification that connections via NAVs should be required to pay the infrastructure charge, as they give rise to a need for reinforcement.

Quotes spanning different charging years

We agree that companies should be transparent about the length of time for which a quote remains valid and that they should make clear what happens where the time-period extends into another charging year. We think the wording in appendix 1 is acceptable. We understand that developers would also like this taken a step further with one consistently applied sector methodology.

Q2: Do you agree with our proposed changes in Appendices 1, 2 and 3?

We are content with the proposed changes in Appendix 1 regarding the charging rules.

Regarding the proposed new and amended terms, in Appendix 2, we have also reflected on the proposals made by the sector's new connections charges sub-group, which we played an active role in. The sub-group worked collaboratively to support commonality in terminology and greater use of worked examples by companies for the benefit of developer customers. Overall, we prefer and support the use of the final sector sub-group proposals that will be provided separately, in response to the consultation, by Water UK. This considers the stakeholder feedback sought directly via the sub-group's customer engagement and our own direct customer engagement. In addition, we generally support the addition of diagrams because developer customers often find these helpful.

However, there is a terminology reference where we believe the original wording is more appropriate than the revised wording being proposed. This relates to the short and long length references being changed to near and far side. We believe that there needs to be a reference to meterage because not all companies have a charge per metre – instead, having a meterage range. The original 4 metre threshold is both reasonable and practical. In addition, we feel that the final sentence of the proposed wording for pre-development enquires could be misleading, as companies would need to inform of necessary works and associated timescales but network reinforcement costs would be borne by companies, not the developer. We therefore suggest this sentence be removed.

Regarding the proposed information requirements, in Appendix 3, we support the proposals to add the new rules A2, (a) to (d), as copied below:

Each undertaker should set out as part of their Charging Arrangements:

- (a) worked examples of every charge that the Undertaker would impose in accordance with these rules under each of the typical scenarios set out in Table 1, including where applicable in any of the scenarios; i.Requisition Charges; ii.Infrastructure Charges; iii.Connection Charges; iv.Any income Offset; v.Any relevant ancillary charges; vi.Clearly itemised unit costs for all relevant services;*
- (b) adequate commentary to the examples to avoid inappropriate comparisons between Undertakers and in any place where the Undertaker has chosen not to follow the specifications in Table 1 to take account of its own specific policies or area-specific terminology and practices;*
- (c) any additional or alternative scenarios where the Undertaker identifies issues with the scenarios or to highlight specific items that it considers could be of particular interest to its customers; and*
- (d) diagrams alongside the worked examples where the Undertaker considers that this will make the worked examples more accessible to Developer Customers.*

Regarding the Table 1 Information requirements for worked examples we support the sector sub-group final proposals that will be provided, in response to the consultation, by Water UK directly. These have the addition of columns showing alternative delivery methods i.e., SLPs and NAVs, which are beneficial for developer customers who can then compare charges across the board. In terms of the charges included within the worked examples we are keen to ensure there is full transparency of the charge composition, and where charges are consolidated there is clarity provided with regards to the individual charge components. We also welcome the additional level of detail regarding - for example - the number of valves or visits required and type of road surface, which will help developer customers and key stakeholders make fair and meaningful charge comparisons across companies.

Q3: We seek your views on our clarification of the five-year rule. In particular, we would like to know of any potential implications for charges and customers' bills from companies following our interpretation.

We set out our views on the five year rule in detail within our response to Ofwat's *Consultation on the scope and balance of developer charges* (published in the [regulatory library](#) on our website). In summary, we believe that averaging expenditure over five years is too short a period over which to consider a very long-term activity like network reinforcement.

This clarification of Ofwat's intent has the effect of making it even more difficult to balance developer charges. The infrastructure charge is the only area of developer charging where companies have any potential flexibility to resolve variances; with other charges we are bound to recover all reasonable costs that have been incurred because charges must be cost-reflective. Developer requirements and the costs we incur when carrying out this work will inevitably be different from what was predicted in a business plan up to 7 years before the activity takes place.

Reducing the ability to balance out infrastructure charges forces the imbalance to be applied to customer bills through the "single till", because there is no outlet for it within developer charges. We do not agree with the statement that this in-period process adjusts tariffs to "match the annual revenue requirement". The revenue requirement is calculated using building blocks which have already factored in a forecast for developer contributions to cost; this means that the base revenue requirement is what a company needs to recover from its regular customers. The "single till" approach then simply adds a forecast of capital income to that revenue requirement. The effect is to create a risk for customers, requiring them to pay more or less depending on the amount of new connection work that companies undertake in response to developer-driven demand.

Nor do we think that the Developer Services Revenue Adjustment (DSRA) will resolve these problems. The DSRA is an imperfect correction for a problem that only exists because of the "single till". It will only work to the extent that differences are driven by volume and provided the all-in unit rate for connections (infrastructure charges plus shallow connection charges) matches the costs incurred. Neither will be true in practice. Even with infrastructure charges, it is not the case that any variances can be explained simply by the difference in the number of connections:

- Some connections pay no infrastructure charge, and others pay a reduced amount. This happens when there was existing infrastructure in an area that has been redeveloped and an infrastructure credit is given or because the connection does not attract an infrastructure charge – for example, a fire supply
- Non-households may pay more than a single infrastructure charge, depending on the number of loading units (i.e. if their usage is equivalent to more than one residential property). If the NHH is served by a 25mm supply they pay a single infrastructure charge for water and sewerage where applicable. If the NHH is supplied by a 32mm or greater supply than the infrastructure charges are at least 1, based on

loading units. NHH properties also get credits where applicable and fire supplies still won't attract an infrastructure charge.

- Like some other companies, we offer environmental incentives for water efficient properties and sustainable drainage. The charges we collect depend on the extent to which developers take these up and the provision of required evidence to demonstrate that developments qualify.
- Some variances will arise from simple timing differences – for example, some connections or costs were expected to occur in a particular year but actually happen in a different one. Adherence to a fixed forward-looking period would mean that all of these become variances to be carried into the RFI mechanism.

Overall, this interpretation of the rule is likely to lead to less cost-reflectivity, greater variances and more volatility in regular bills for water and wastewater. As such, we do not think it operates in the customer interest. In 2020-21 we recovered £5.5m less capital income than forecast for the wastewater service (as highlighted in our commentary to this year's APR); infrastructure charges made the largest contribution to this variance. This imbalance equates to 0.7% of the revenue cap. If the infrastructure charge can flex in response to over or under recovery, then this difference could be recovered through a higher charge in future years; if it cannot then bill-paying customers will see an increase of around 0.7% as a result of developer activity which has nothing to do with them.

In our response to the *Balance and scope of developer charges*, we set out some alternative approaches to setting infrastructure charges. But if Ofwat wishes to keep the five-year rule for the current period, we think that it should (at least) allow for over or under-recovery against the charge from prior years to be factored into company calculations when setting infrastructure charges for the following year.